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Anthony Norris

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Fraudulent Transfer Against Another Creditor When the Debtor is in Bankruptcy**

Anthony Norris, J.D. Candidate 2021

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Introduction

In order to effectuate the efficient resolution of bankruptcy proceedings, courts have followed the public policy of reducing the number of suits that are ancillary to a bankruptcy case.¹ Courts have achieved this goal by limiting those that have standing once a bankruptcy case is initiated.² Thus, courts will appoint a trustee who alone has standing to handle the estate of the debtor.³

Typically, the issue of standing will be straightforward when a creditor sues a debtor. However, the question becomes more complicated when a creditor sues another creditor, where their only connection is the debtor.⁴

This memorandum focuses on whether a creditor can assert breach of fiduciary duty and fraudulent transfer claims against another creditor if the mutual debtor is in bankruptcy. Part I provides the legal standard dictating when a claim can be brought by an individual creditor

¹ See *Matter of Richman*, 104 F.3d 654, 656-57 (4th Cir. 1997).

² *Id.*

³ See *Id.* at 646; See also 11 U.S.C. § 323.

⁴ See e.g., *Artesanias Hacienda Real S.A. de C.V. v. North Mill Capital LLC*, 607 B.R. 189, 193-94 (E.D. Pa. Aug. 8, 2019) (where plaintiff creditor sued defendant creditor claiming that the defendant engaged in fraudulent transfers with the debtor and violated fiduciary duties owed to plaintiff creditor).

during bankruptcy and the exception to the rule. Part II discusses, in three separate sections, a creditor's claim for breach of fiduciary duties, a claim for fraudulent transfer, and derivative standing.

I. Causes of Action Brought During the Pendency of a Bankruptcy Case Belong to the Estate Unless Unique to an Individual Creditor

Causes of action that are generalized to all creditors cannot be brought by individual creditors as the claims belong to the debtor's estate. An estate is "all legal or equitable interests of the debtor in property as of the commencement of the case."⁵ The interests of the debtor (and thus the estate) include any generalized causes of action.⁶ The causes of action belonging to the estate are not limited to those against the debtor: "Although the claims raised by [creditor] are not against the debtor but are against a third party, the same reasoning applies."⁷ Whether a cause of action is defined as property belonging to the estate will be determined by state law, in the absence of conflict with federal law.⁸ It is therefore the trustee's responsibility to bring causes of action that belong to a debtor's estate, including those that are ancillary to the debtor's bankruptcy but not specifically against the debtor.

Claims alleging fraud, such as alter ego claims, are general claims that only a trustee can bring. For example, in *St. Paul Fire and Marine Ins. Co.* the court found that PepsiCo's allegations of alter ego illustrate injury generalized to all creditors of a debtor, and thus must be brought by the trustee.⁹ In this action, PepsiCo, Inc. ("PepsiCo") filed a third-party complaint against Banner Industries, the parent company of Commercial Lovelace Motor Freight, Inc. ("CL").¹⁰ CL bought Lee Way Motor Freight, Inc. ("Lee Way") from PepsiCo, with PepsiCo's

⁵ 11 U.S.C. § 541(a)(1).

⁶ See *Board of Tr. of Teamsters Local 863 Pension Fund v. Foodtown, Inc.*, 296 F.3d 164, 169 (3d Cir. 2002).

⁷ *St. Paul Fire and Marine Ins. Co. v. PepsiCo, Inc.*, 884 F.2d 688, 701 (2d Cir. 1989).

⁸ See *In re Morton*, 866 F.2d 561, 563 (2d Cir. 1989).

⁹ 884 F.2d at 703-05.

¹⁰ *Id.* at 690.

guarantee on bonds issued to Lee Way still outstanding.¹¹ Lee Way, now owned by CL, then sold assets to CL, leaving Lee Way without assets to pay off its debts.¹² Lee Way soon declared Chapter 11 bankruptcy.¹³ PepsiCo was then called upon to pay its guarantee.¹⁴ PepsiCo asserted two causes of action against Banner: (1) that Banner was CL's alter ego, and (2) that Banner caused PepsiCo's loss "in whole or material part by the wrongful diversion of Lee Way assets."¹⁵ In regards to PepsiCo's alter ego claim, the court stated that "PepsiCo has not shown that this harm differs in kind from the harm suffered by any other creditor of CL or Lee Way."¹⁶ Similarly, PepsiCo's second claim was also "no more than a claim of generalized harm to the estate."¹⁷ Since PepsiCo's claim was general and PepsiCo was harmed no differently than other creditors, it should have been brought by the trustee.

However, as an exception to the general rule, the trustee cannot bring claims that are individualized to a particular creditor.¹⁸ Personal injury, on the other hand, is injury unique to the creditor and may be brought by an individual creditor.¹⁹ In order to determine whether injury is unique to an individual claimant, "a court must look to the injury for which relief is sought and consider whether it is peculiar and personal to the claimant or general and common to the corporation and creditors."²⁰ The inquiry is thus deciding whether the debtor's estate is injured (injuring creditors indirectly) as opposed to analyzing whether the actions by creditors are common to a number of them.²¹ The court will thus engage in a factual inquiry and seek to

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at 692.

¹⁴ *Id.*

¹⁵ *Id.* at 690. It appears that PepsiCo is making a fraudulent transfer claim. The court acknowledges that the claim as stated is not sufficient for a valid cause of action. *See St. Paul Fire and Marine Ins. Co.*, 884 F.2d at 705.

¹⁶ *Id.* at 704.

¹⁷ *Id.* at 705.

¹⁸ *See Foodtown*, 296 F.3d at 170.

¹⁹ *Id.*

²⁰ *Koch Refining v. Farmers Union Cent. Exchange, Inc.*, 831 F.2d 1339, 1349 (7th Cir. 1987).

²¹ *See In re Schimmelpennick*, 183 F.3d 347, 360 (5th Cir. 1999).

classify the relief as specific to the individual creditor, or applicable to all creditors by injury to the debtor's estate.

Claims alleging that misrepresentations were made to specific creditor(s) (but not all of the creditors) are individualized claims that can be brought by those affected creditors. For example, in *Matter of Educators Group Health Trust*, the court determined that specific representations were made only to a specific group of creditors, and so they had standing to sue without relying on the trustee.²² Educators Group Health Trust (EGHT) was created to provide health benefits to teachers.²³ In 1988, EGHT filed for Chapter 7 bankruptcy.²⁴ As a result, the participating school districts became creditors of the estate.²⁵ The plaintiffs in this case include seven of the two hundred school districts that participated in EGHT.²⁶ They allege fraud, conspiracy to commit fraud, negligence, inter alia.²⁷ The court held that these claims were particularized injury because “plaintiff school districts allege . . . that the defendants intentionally misrepresented *to them* the financial situation of EGHT.”²⁸ Here, the court italicized the words “to them” to emphasize the necessity of individual harm.²⁹ In other words, EGHT, the plaintiffs allege, did not make broad misrepresentations to all of the school districts, but did so in their negotiations *specifically* with plaintiff schools.

II. Claims for Breach of Fiduciary Duties and Fraudulent Transfer are General Claims

A. The Trustee is the Proper Person to Assert a Claim for Breach of Fiduciary Duties Because They are Generalized Claims

²² 25 F.3d at 1286.

²³ *Id.* at 1283.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at 1286.

²⁸ *Id.* at 1285.

²⁹ *Id.*

Claims for breach of fiduciary duties cannot be brought by an individual creditor when the debtor files for bankruptcy relief. Claims for breach of fiduciary duties generally do not require the application of bankruptcy law and can thus be resolved outside the bankruptcy context.³⁰ This is because fiduciary duties owed by directors and officers of a debtor do not typically extend to creditors.³¹ Instead, fiduciary duties to creditors will arise when a debtor corporation becomes insolvent.³² When these fiduciary duties arise, “creditors of an insolvent corporation are precluded from asserting direct claims against the corporate directors for a breach of their fiduciary duties. Instead, creditors may pursue derivative claims on behalf of the insolvent corporation.”³³ So, fiduciary duties to creditors only arise when a corporation becomes insolvent and breach of which would similarly affect all other creditors.³⁴ Naturally, then, when a corporation is in bankruptcy, a creditor will individually be unable to claim breach of fiduciary duties and must seek relief through the trustee, or through pursuing a derivative claim.

B. The Trustee is the Proper Person to Assert a Claim for Fraudulent Transfer Because it is a Generalized Claim

A fraudulent transfer claim cannot be brought by an individual creditor when the debtor files for bankruptcy. Section 544 of the Bankruptcy Code provides that the trustee shall “step into the shoes of a creditor for the purpose of asserting causes of action under state fraudulent conveyance acts for the benefit of all creditors, not just those who win a race to judgment.”³⁵ As such, the Supreme Court has held that creditors cannot maintain an action for fraudulent transfer

³⁰ See *In re Allied Systems Holdings, Inc.*, 524 B.R. 598, 606 (Bankr. D. Del. 2015).

³¹ See *In re Forman Enterprises, Inc.*, 281 B.R. 600, 610 (Bankr. W.D. Pa. 2002).

³² See *In re Insulforams, Inc.*, 184 B.R. 694, 703-04 (Bankr. W.D. Pa. 1995).

³³ *In re Bruno*, 553 B.R. 280, 286 n.39 (W.D. Pa. 2016).

³⁴ See *Id.*

³⁵ *In re MortgageAmerica Corp.*, 714 F.2d 1266, 1275 (5th Cir. 1983).

because such action is vested in the trustee.³⁶ This is because a fraudulent transfer claim is one that would injure the debtor's estate and indirectly affect all creditors. Thus, a fraudulent transfer claim will need to be brought by the trustee, or through pursuing a derivative claim.

C. A Derivative Claim Allows a Creditor to Pursue Actions Otherwise Belonging to the Trustee

Through derivative standing, a creditor can step into the trustee's shoes and assert claims on behalf of an estate. A creditor can obtain standing to pursue a derivative claim if either (1) the trustee consents to the creditor pursuing such action, or (2) the trustee unreasonably refuses to bring the creditor's claims.³⁷ Creditors must seek permission from the bankruptcy court to bring a derivative claim.³⁸ Therefore, it is possible to bring claims for breach of fiduciary duties and fraudulent transfer through derivative standing if the creditor(s) first seek permission from the trustee and the court, or the trustee unreasonably refuses to bring the claim itself and the court grants approval to bring the action notwithstanding the trustee's refusal to bring the action.

Conclusion

Creditors wishing to assert generalized claims against other creditors of a mutual debtor must rely on the trustee to represent their interests and accept that they will be bound by the trustee's action, or obtain derivative standing.³⁹ If a creditor can show injury that is unique and independent of the debtor's estate, it is possible for the creditor to assert that claim on its own behalf.⁴⁰ However, determining whether the creditor's injury is unique requires a factual inquiry into the relief sought, which leaves ample discretion to the courts and little guidance in terms of predictability. Furthermore, creditors will generally be unable to assert claims for breach of fiduciary duty or fraudulent transfer against another creditor when the debtor is in bankruptcy

³⁶ See *Glenny v. Langdon*, 98 U.S. 20, 27-28 (1878).

³⁷ See *In re Racing Services, Inc.* 540 F.3d 892, 905 (8th Cir. 2008).

³⁸ *Id.* at 899.

³⁹ *St. Paul Fire and Marine Ins. Co.*, 884 F.2d at 701.

⁴⁰ *Id.*

unless the creditor can obtain derivative standing.⁴¹ Nonetheless, holding that creditors lack standing to pursue generalized claims, such as claims for breach of fiduciary duties or fraudulent transfer, is necessary to prevent creditors racing for judgments and thereby reducing the debtor's assets available for equitable distribution.

⁴¹ See *In re Bruno*, 553 B.R. at 286 n.39; See also *Langdon*, 98 U.S. 27-28.